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BARRIERS TO FREE MOVEMENT DUE TO MISMATCHES OF CROSS BORDER TAX AND SOCIAL SECURITY INSTRUMENTS[1]

Abstract

The rules for coordinating tax and social security have important differences, and this may be disadvantageous for mobile workers, in particular for posted workers. In this article the differences are analysed and the effects of the rules are shown. The article concludes by giving some suggestions for solving the problems

Słowa kluczowe: koordynacja, pracownicy mobilni, zabezpieczenie społeczne, podatki, prawo Unii Europejskiej

Key words: coordination, mobile worker, social security, tax, EU law

Introduction

Free movement of workers is one of the four pillars of the EU. There are, however, – even after 60 years since the establishment of the European Community – still important barriers for making use of this right to free movement. In this article I will focus on the problems of persons who work in another Member State than where they reside or work in more than one Member State due to differences in the principles and application of social security contributions and tax rules. It is already an old problem, but it seems to become more pressing now mobility is increasing.[2]

[1] This paper was prepared for conferences at the University of Economics, Prague and at the University of Copenhagen in September and November 2017, which was organised by these universities and KPMG.

[2] F. Pennings, M. Weerepas, *Towards a convergence of coordination in social security and tax law?*, EC Tax Review 2006, 4, p. 215–225.

Some preliminary remarks

Mismatches between tax and social security contributions affect mobile workers, in particular posted workers and persons working simultaneously in more than one Member State. Before discussing these first some fundamental issues will be addressed.

The starting point for the discussion is that for EU coordination of contributions and coordination of taxes completely different systems exist. For social security there has already been a E(E)C/EU coordination instrument since the foundation of the European Community in 1957. It was acknowledged that, in order to promote free movement of workers, it is essential that EU regulations ensure that migrant workers do not lose benefit rights as a result of their cross border movement. Article 51 of the 1957 Treaty provided the legal basis for such coordination rules. To elaborate this article, in 1958 Regulation 3 came into force.[3] This Regulation was succeeded by Regulation 1408/71,[4] that was on its turn succeeded by Regulation 883/2004.[5]

However, even though also tax liability is very relevant to free movement, no coordination system for taxes was made. Also currently the Treaty (TFEU) does not provide the Council with powers to make tax coordination rules. This follows from the principle that the power to regulate tax has remained exclusively within the competences of the national States, since tax can be levied for many objectives, which makes that it is much more difficult to decide which country has to receive the levies than in case of social security. Basically, the country that receives the contributions has to pay the benefit if the risk materializes. If a person works in one country and lives in another, s/he benefits from the expenses of both countries (infrastructure, defense, etc.), so it is not so easy to assign the country that should receive all taxes.

However, for free movement measures to avoid double taxation are necessary; it is primarily left to national States to take such measures. For this purpose they have made bilateral agreements with other Member States. For drafting these conventions they usually use the OECD Model Convention as a model.[6]

Tax conventions do not cover social security contributions. The commentary to Article 2 of the Model Convention reads that social security charges, or any other charges paid where there is a direct connection between the levy and the individual benefits to be received, shall not be regarded as 'taxes on the total amount of wages'.

As a result, there are different coordination systems for taxes and social security, which are not adjusted to each other. It is possible, for instance, that a worker is subject to contributions in country x and subject to tax in country y, or, more often, s/he has to pay taxes in country x and also in country y and also contributions in one of these

[3] Official Journal of the EU (OJ) 1958, 30.

[4] OJ 1971, 149, p. 2.

[5] OJ L 2004, 2001, p. 1.

[6] http://www.oecd.org/ctp/treaties/model-tax-convention-on-income-and-on-capital-2015-full-version-9789264239081-en.htm (accessed: 20.09.2018).

countries. These rules are not necessarily adjusted to each other, so they may overlap and thus levy higher charges on the migrant workers than under domestic law. The income effects of such disparity can be considerable.[7]

Another cause for the disparity is the lack of clear definitions of essential terms. Even the distinction between social security contribution and tax levy is not always clear. In several judgments the Court of Justice made clear that if a payment is made to finance a particular benefit and is paid in a specific fund, it is to be treated as a social security contribution, regardless of its name in domestic law (*Commission versus France*[8]). As a result if a person is subject in his State of residence to a payment, that is called tax but satisfies the conditions for social security contribution, s/he does not have to pay this payment if s/he works in another Member State, since under the social security coordination rules a worker is basically subject to the legislation of the country of work only.

Sometimes, however, the situation is unclear and State A considers a payment as a social security contribution and State B considers it as a tax, and the criteria mentioned do not lead to a solution. In that case it can be uncertain whether a payment is to be treated under the coordination regulation or under the double tax convention. It is difficult to come to a solution in such cases.

If social security schemes are paid from taxes which do not provide criteria to distinguish which is used to finance social security and which is spent for other purposes, the payments to this fund are not considered as social security contributions and the coordination Regulation cannot be applied. As a result these workers have to pay 'double'; in fact they also contribute to the social security system to which they are not subject according to the social security coordination rules. Because of this system, it is important to maintain or even (re)introduce contribution systems for social security, and not pay them from taxes. Tax lawyers sometimes tend to regard social security as just another word for tax, but in cross border situations the distinctions are very important.

Another example of differences and uncertainties on terms concerns 'residence' and 'employer'; they may have different meanings in the tax conventions and the coordination regulation and that may mean that there are differences in outcome of the applicability of the coordination instruments.[9]

Another problem is that Member States have different systems for financing social security. For example, State A has a tax-financed social security scheme and State B a contribution financed scheme. In State B, where the major part of the social security budget comes from contributions, taxes are considerably lower than in State A. If a mobile person has relations with both States, s/he may be subject to much higher or lower levies than in purely national situations, depending on which work the person lives and works.

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[7] B. Spiegel, K. Daxkobler, G. Strban, A.P. van der Mei (FreSsco network), *Analytical Report 2014: The Relationship between Social Security Coordination and Taxation Law*, European Commission, Brussels 2015 (hence: FreSsco Report) gives some examples of the differences in net income that can occur.

[8] Case 34/98, [2000] ECR I-995.

[9] See also FreSsco Report, p. 15.

There are also situations in which there is no uncertainty whether a payment is a contribution or tax levy, but where rules lead to different outcomes on which State is competent to levy contributions or taxes.

Such different outcomes can occur, in particular, in the case of posting and in the case of frontier workers and in the situation of persons simultaneously employed in more than one Member State. These outcomes will be discussed in the next section. Section 4 discusses a person working in another Member State than where s/he resides and Section 5 deals with posting. Section 6 deals with persons working in two States simultaneously; Section 7 summarises the most important problems and Section 8 mentions some possible solutions.

The institutional framework for international social security and for tax levying

Social security coordination rules

I will not describe the framework for the coordination of social security here, since that has been done already on several other places,[10] but limit myself to what is necessary for the comparison of social security coordination with the tax coordination.

Important is that the underlying principle of the system of social security coordination is that freedom of movement of persons is to be promoted. For the objective of promoting free movement social security coordination is essential, since workers cannot be expected to go abroad if that has negative effects on their social security position. Without interference by international legislation, such negative effects of crossing the borders are unavoidable. For the Court of Justice this objective has been very important for its interpretation of provisions of the coordination Regulation: the interpretation of coordination rules must be in the light of the promotion of the mobility of workers. The Court has consistently sought and still seeks, where possible, such interpretations of coordination provisions that may remove negative effects of migration. Examples are the broad interpretations of the terms 'employed person' and 'self-employed person' in, respectively, the *Unger* judgment[11] and the *Van Roosmalen* judgment,[12] which interpretations resulted in a broad personal scope of the coordination Regulation.

A major principle underlying the rules for determining the social security legislation applicable is that not more than one legislation must be applicable at the same time, in other words they have *exclusive effect.* This means that at any given time the social security legislation of only one Member State is applicable.

[10] See, for instance, F. Pennings, *European Social Security Law*, Intersentia, Antwerp 2015.

[11] Case 75/63, [1964] ECR 369.

[12] Case 300/84, [1986] ECR 3097.

The designation of the legislation of State x instead of that of State y means that the person concerned is covered by the legislation of State x only. As a result the social security system of State x applies, according to the rules of that system, to the activities and the income derived from these activities in both countries. In other words, the contribution rules of State x are applied on the total income earned in both countries, and the thus calculated contributions have to be paid solely to State x. The person is insured in State x only and acquires, for instance, old age benefit rights in this State only.

The exclusive effect follows from Article 13(1) of the coordination Regulation, since this article provides that, except for some specific exceptions, persons falling under the Regulation are subject to the legislation of one Member State only.

Principles underlying the coordination of taxation

As was mentioned in Section 1 already, the Treaty does not give the European Council the competence to make coordination rules for tax. An older provision, Article 293 EC, required that *Member States* (my italics) have to work in mutual cooperation in order to abolish double taxation for their residents within the Community, but this provision was not included in the TFEU.

The Model Convention does not impose exclusive effect of the tax rules; as a result persons may be subject to tax in more than one State. It is also possible that persons are subject to social security contributions in a State other than where they are subject to tax law.

Many States take the income of their residents into account for the purpose of tax, regardless of where this income is earned. This follow the so-called world income principle, which is often mentioned in international tax law. In addition, States impose tax on income earned in their territory, even if the person concerned lives in another State. This is according to the so-called source State principle.

As is easy to understand, if both principles are applied, double taxation can occur. A person is confronted by the tax law of the State where s/he works (source principle) and also of the State where s/he lives (world income principle). This can affect free movement of workers, since workers can be deterred from working in another country if higher levies are imposed as a result. It is, of course, also a matter of fairness that a person must not have to pay 'too much' tax. Therefore solutions have to be found in case of double taxation.

It is not easy to reach agreement on a comprehensive system, and certainly not on exclusive effect in tax coordination. This is because taxes can be used to finance an, in principle, unlimited range of provisions; for social security contributions coordination is easier as the contributions are used to finance, in principle, solely social security benefits.[13]

[13] B. Peeters, H. Verschueren, *The impact of European Union law on the interaction of member states' sovereign powers in the policy fields of social protection and personal income tax*, EC Tax Review 2017,

Specific situations in which contribution and tax coordination rules may give different outcomes

A person works in a State other than the State of residence

The rules on avoiding double taxation depend on the type of income. In case of income from employment the tax rules are regulated in Article 15 of the MC. The main principle is that the State of residence of the person concerned is competent. However, in case of income from work, the taxing right is given to the State of employment. In such case, the residence State may avoid double taxation by using either the exemption method or the credit method.

In the system of the double tax conventions only one of the two contracting States can be the residence State, for which purpose the meaning of the term residence is important. Article 4 of the Model Convention provides the criteria for which State is to be regarded as the residence State. Domicile, residence and similar criteria are relevant as a starting point; if this is not decisive the availability of a habitual home has to be taken into account. Subsequently, the centre of the taxpayer's vital interests, the taxpayer's usual abode and the taxpayer's citizenship are considered. Finally, a mutual agreement procedure has to be followed if the residence State of the person concerned cannot be decided in any other way.

According to the coordination rules for social security the major rule is that a person pursuing an activity as an employed or self-employed person in a Member State shall be subject to the social security legislation of that Member State – Article 11(3) of Regulation 883/2004. 'Pursuing an activity as an employed or self-employed person' means any activity or equivalent situation treated as such for the purposes of the social security legislation of the Member State in which such activity or equivalent situation exists. Thus the national social security legislation is relevant to know whether a person works as an employed person. For example, if a person is covered by an insurance scheme for employees, s/he is an employed person for the Regulation. A person who is, although working under a contract of employment, not covered by an employees' scheme is therefore not an employed person for the Regulation.

Even though these principles for both social security and tax assign the same country where the payment has been done, there can still be problems if the social security systems of the countries concerned are financed differently. Suppose State A has a tax-financed social security scheme and State B a contribution financed scheme. Suppose that in State B the major part of the social security budget comes from contributions, and therefore taxes are considerably lower than in State A. If a mobile person has relations with these two States, this can result in much higher or lower levies than in purely national situations.

25 (5/6), p. 262–276; H. Verschueren, *The renewed EU social security coordination in Regulation No. 883/2004 and its link with bilateral tax agreements*, EC Tax Review 2012, 21 (2), p. 98–111.

Frontier workers

Frontier workers belong to the category of persons working in a State other than the State of residence, and may even seem to be the major category of migrant workers. However, frontier workers are not dealt with as such by the Model Convention; they can be a separate category in the double tax convention, for which category States specific rules are given, deviating from the distribution rules of Article 15 of the Model Convention. Some of these conventions give the right to levy tax to the State of residence, whereas in some cases partial reimbursement is regulated. These reimbursements can be to the benefit of the employee or of the State of employment.

Traditionally, double tax conventions gave the State of residence the right to collect taxes from frontier workers, but in some conventions the State of employment is made competent for levying taxes. In the latter case a reimbursement system for the State and/or employee concerned was introduced. The tax conventions describe the categories to be considered as frontier workers by drawing borderlines over their territory: people living within such region and working in the other Member State are treated as frontier worker.

In social security for frontier worker there are no specific rules for determining the legislation applicable, but the general rule applies; a person living in one State and working in the other State (and not also in the State of residence) is subject to the legislation of the State of employment.

This can mean that the State of employment is responsible for social security and the State of residence for tax, as these can be problematic because of the different outcomes. This was effect is considered undesirable because of its negative impact on free movement of workers.

In order to find a solution, in 1979 the European Commission published a draft directive, which required levying taxes in the State of residence. This proposal was withdrawn.[14]

In 1993 the European Commission issued a recommendation, which promoted the State of employment principle.[15] The recommendation, which is not binding on the Member States, requires Member States to guarantee a non-discriminatory treatment of non-residents who earn at least 75 per cent of their income in their territory.

This recommendation seems to be followed by some Member States, which revised their double tax conventions. For instance, the double tax conventions of Netherlands and Germany and of the Netherlands and Belgium were replaced to new ones in order to apply the country of employment principle also to frontier workers. In the Dutch-Belgian situation it happened, under the previous convention, that in one country income taxes were raised, whereas social security contributions were reduced with the same amount, in order to neutralise income effects. Such a measure could be considered desirable,

[14] Directive of 21 December 1979, 79/737, PB EG 1980, C 21, p. 6.

[15] Recommendation of 21 December 1993, 94/79/EG, OJ 10 February 1994, L 39, p. 22.

as it made workers cheaper when the social security contributions were lower, and the higher taxes were applied on more sources than income from employees only, whereas the total revenues for the State remained the same. For purely national workers this measure did not have income effects. For frontier workers, however, this was different: persons living in the State with the increased taxes, and working in the other State, the increased tax was not compensated by a reduction in social security contributions: they suffered adverse income effects. Frontier workers in the opposite situation, however, received a higher net income and had thus little reason to complain.

The differences in effects of the coordination rules of the old double tax convention brought the Netherlands and Belgium to adopt a new double tax convention that no longer applies the State of residence principle, but income taxes from work are in principle paid in the State of employment; this is the Double Tax Convention Belgium Netherlands 2003. The tax coordination system was thus adjusted to the social security coordination.[16]

Posting

The main rule for income from work is that taxing takes place in the State of employment. According to the Model Convention, however, for posted workers the taxing right remains with the residence State if the '183-days rule' applies, but only under the following conditions:

- the taxpayer must be present in the other State for no longer than 183 days in any 12-months period, commencing or ending within the fiscal year;
- the remuneration must be paid by or on behalf of an employer who is not a resident of the other State;
- the remuneration is not borne by a permanent establishment that the employer has in the other State.

All three of these conditions have to be fulfilled. If one or more of them do not apply, the taxing right is with the working State. Thus: if the taxpayer is present in the working State for more than 183 days within a period of 12 months that commences or ends in the fiscal year concerned, the taxing right is always granted to the working State. If the taxpayer works less than 183 days within this period in the other State, it has to be checked whether the taxpayer's remunerations are paid by or on behalf of an employer who is not resident in the working State and whether the taxpayer's remunerations are not borne by a permanent establishment of the employer in the working State.

Thus even if a person is working less than 183-days in a State, this Member State has the taxing rights if the office in the State of work qualifies as a permanent establishment in the sense of Article 5 of the Model Convention and if the remuneration is borne by

[16] Note that for tax there are several problems which does not exist for social security, for instance, that, in order to reach equal treatment, the Dutch rules which allow deduction of mortgage interest from tax must now also allow mortgage interest of houses in Belgium being deducted from Dutch taxes.

that permanent establishment. A company usually has a permanent establishment in the other State if there is a fixed place of business and the activities performed there are not merely of an auxiliary or preparatory nature. If there is a permanent establishment in the Member State of work, the question is whether the person's remuneration is also borne by that permanent establishment.

Article 15 can involve that in case a person has jobs in different States, one State is competent for levying tax on job a and the other on job b.

Also for social security contributions an exception is made to the main rule that the legislation of the State of employment is applicable in case of posting, but this has a different meaning than in tax law. This exception is found in Article 12 of the coordination Regulation. This article provides that a person employed in the territory of a Member State by an undertaking to which he is normally attached and who is posted by that undertaking to the territory of another Member State to perform work there for that undertaking shall continue to be subject to the legislation of the first Member State, provided that the anticipated duration of that work does not exceed 24 months and that he is not sent to replace another person who has completed his term of posting. Also self-employed persons can be posted. Also for them posting is possible for a maximum period of twenty-four months.

It is clear that the posting rules are indispensable for free movement. Regulation 883/2004 has an even longer posting period than its predecessor: twenty-four months instead of twelve months.

In addition, it has to be remarked that under Article 16 of the Regulation it is possible to have considerable longer posting periods. This article provides that 'Two or more Member States, the competent authorities of these Member States or the bodies designated by these authorities may by common agreement provide for exceptions to Articles 11 to 15 in the interest of certain persons or categories of persons'. Consequently, if a person goes to work in another Member State, it can be defined by the agreement between the competent authorities how long he will remain subject to the social security system of the State of origin. In many Member States, the competent bodies limit the duration of such agreements to a maximum period of five years.

As a result it can happen that after the period of 183 days a posted worker has to pay tax in the State of employment, while his social security contributions are still to be paid in the State of residence. Moreover, not only the duration of the period is relevant to be subject to tax law in the State of residence: also the remuneration must not be at the charge of the employer in the State of employment nor due by a permanent establishment or permanent representative in the State of employment. In one respect the tax rules are broader for allowing posting: the replacement of a previously posted employee does not have any significance for tax. For coordination of social security the residence of the person concerned is not decisive. It is immaterial that the posted employee keeps his or her place of residence in the posting Member State or transfers his or her residence to the Member State where the work is exercised during the posting period.

See, for an overview of the differences in the area of posting, Table 1. In this figure we assume that the person was first working in his State of residence and then in another Member State and that posting means that he remains subject to the law of the State of residence.

Table 1. The Conditions for posting in tax and social security law

	TAX	SOCIAL SECURITY
The employee is sent for a period of less than 183 days for the account of the employer in State of residence	State of residence	State of residence
The employee is sent for a period of more than 183 days for the account of the employer in State of residence, but less than 24 months	State of employment	State of residence
The employee is sent for a period of less than 183 days, but replaces another worker or is not working on account of the employer for whom he normally works	State of residence	State of employment

Source: Own work.

Persons working in two States simultaneously

For social security there is complex set of rules on which State is competent to levy social security contributions. Article 13(1) provides that a person who normally pursues an activity as an employed person in two or more Member States shall be subject to the legislation of the Member State of residence if s/he pursues *a substantial part* of his/her activity in that Member State. These conditions applies regardless of the number of employers.

This condition means that the distinction between substantial and non-substantial is crucial. Regulation 987/2009, the so-called Implementing Regulation, mentions some criteria for when an activity is substantial (Article 14): the proportion of activity pursued in a Member State is in no event substantial if it is less than 25 per cent of all the activities pursued by the worker in terms of turnover, working time or remuneration or income from work.

This provision does not give very sharp rules and it only indicates when work is not substantial and it leaves alternative ways to define what is substantial.

However, the effect of this rule may be, depending on the situation and the applicable criteria, that for full-time workers working one day a week in their State of residence is often insufficient for having the legislation of the residence State applying to them.

As a result marginal work or working at home for your employer will not as easily as under Regulation 1408/71, involve that the legislation of the State of residence applies.

If the worker does not pursue a substantial part of his/her activity in the Member State of residence, the following rules apply:

1) if the worker is employed by one undertaking or employer, s/he is subject to the legislation of the Member State in which the registered office or place of business of the undertaking or employer is situated;

2) if the worker is employed by two or more undertakings or employers which have their registered office or place of business in only one Member State, s/he is subject to the legislation of the Member State in which the registered office or place of business of the undertakings or employers is situated;

3) if the worker is employed by two or more undertakings or employers, which have their registered office or place of business in two Member States, one of which is the Member State of residence, the worker is subject to the legislation of the Member State in which the registered office or place of business of the undertaking or employer is situated other than the Member State of residence;

4) if the worker is employed by two or more undertakings or employers, at least two of which have their registered office or place of business in different Member States other than the Member State of residence, s/he is subject to the legislation of the Member State of residence.

Table 2 gives an overview.

Table 2. The rules for determining the legislation applicable in case of working simultaneously in two countries

Extent of activities	Number of employers	Applicable legislation
Substantial activities in State of Residence		Legislation of State of residence
Non-substantial activities in State of Residence	One employer	Legislation of State of registered office of that employer
	Two employers, with registered office in same Member State	Legislation of State of registered office of employers
	Two employers, with registered office of one employer in State of residence	Legislation of State other than of residence
	Two employers, with registered office both not in State of residence	Legislation of State of residence

Source: Own work.

The Implementing Regulation gives rules on how to decide that the criteria of application of the legislation of the State of residence or another State are fulfilled. This applies also in other situations governed by Article 13 of the basic Regulation where there may be uncertainty. Article 16 of the Implementing Regulation provides that a person who

pursues activities in two or more Member States has to inform the competent authority of the Member State of residence. This institution has to determine the legislation applicable to the person concerned. That initial determination is provisional only. The institution then informs the designated institutions of each Member State in which an activity is pursued of its provisional determination. The provisional determination becomes definitive within two months of the institutions designated by the competent authorities of the Member States concerned being informed of it, unless the legislation has already been definitively determined, or at least one of the institutions concerned informs the institution designated by the competent authority of the Member State of residence by the end of this two-month period that it cannot yet accept the determination or that it takes a different view on this. Where uncertainty about the determination of the applicable legislation requires contacts between the institutions or authorities of two or more Member States, at the request of one or more of the institutions designated by the competent authorities of the Member States concerned or of the competent authorities themselves, the legislation applicable to the person concerned shall be determined by common agreement.

The Implementing Regulation defines what is meant by 'registered office or place of business': these terms refer to the registered office or place of business where the essential decisions of the undertaking are adopted and where the functions of its central administration are carried out (Article 14(5a)).

Residence is thus very important to determine the applicable legislation. For the coordination Regulation only one place of residence is relevant. This appeared from the *Wencel* judgment.[17]

For taxation, apart from situations of short-term work (less than 183 days in a tax year or specific rules, e.g. on frontier workers) it is the country where the work is performed that collects the taxes, and that may be the case in more than one State simultaneously.

As a result, if a person works frequently in other Member States, e.g. on particular projects, s/he will remain covered by the State of residence for social security contributions since more than 25% of all the activities are exercised in the Member State of residence. The other States do not have any right to levy additional contributions. As regards taxation, the State where the acting activity is exercised has the right to taxation. Thus, Member State where the activity is performed has the right to levy tax on the income earned by the person concerned. Depending on the method to avoid double taxation, the State of residence will either exempt this income from taxation or credit the taxes levied in the other Member State against its own tax.

[17] Case C-589/10, ECLI:EU:C:2013:303.

Table 3. Comparison of the assignment of competent state for taxes and social security contributions in case of working in two countries simultaneously

Extent of activities	Number of employers	Applicable social security legislation	Applicable tax legislation
Substantial activities in State of Residence		Legislation of State of residence	In both states
Non-substantial activities in State of Residence	One employer	Legislation of State of registered office of that employer	In both states
	Two employers, with registered office in same Member State	Legislation of State of registered office of employers	In both states
	Two employers, with registered office of one employer in State of residence	Legislation of State other than of residence	In both states
	Two employers, with registered office both not in State of residence	Legislation of State of residence	In both states

Source: Own work.

Summary

From the previous sections it follows that the principles underlying international coordination in tax and social security are different. A main difference is that a person can, in principle, be subject to only one social security system at the same time, whereas he can be subject to more tax systems simultaneously. We have seen that the reason for this is that social security contributions are paid for benefits and thus have a single function. This function can be left to the State that is responsible for the social coverage of the person concerned, even if the protection is to be based on the two incomes he earns simultaneously in two different States. Tax is used to finance very many functions, which cannot be attributed to one country (like schools for children, maintenance of roads, culture etc.).

A second difference is the technique of the distribution rules. In social security one State is the competent one and the contribution rules of that State are applied on the income earned in both States in case a person is working in both States. The State which is not competent is excluded from levying contributions. In tax the distribution rules mean that taxes are calculated in both States on the income of an employee, but subsequently the person concerned is exempted (partially of completely) from taxes in the State of residence. For other sources of income than from work as an employee, the distribution rules can make the State of residence competent. This is true, for instance, for persons receiving a pension.

A third difference is that coordination of social security is, within the EU, meant to promote the free movement of workers. The double tax conventions do not have such a basic objective.

The main differences between social security contribution coordination and tax distribution rules are the following

Social security is dealt with by EU instruments, i.e. directly applicable EU Regulations which apply in the same way to all Member States. Rules on taxation are subject to national legislation and/or bilateral double tax conventions, which are usually based on the Model Convention, but there may be some deviations.

Residence is an important element in both social security and tax coordination. Nevertheless, the term does not have the same meaning in both systems. For tax it is up to the State to decide what the State of residence is, but a permanent housing in a State where the person has his or her centre of vital interests is seen as the residence State for a considerable period.[18] In security coordination a transfer of residence could take place much sooner.

Secondly, the notion of permanent establishment is important for tax, but not for social security.

Pathways to solutions

A first problem is that the interpretation of several terms is unclear. There are many unanswered questions on rules on social security contributions and taxes.

One approach could be to make it clearer which types of contributions fall under Regulation 883/2004. This gives better guidance in cases where levies are treated as taxes by the Member States concerned but in fact have to be treated as social security contributions due to their link with the risks covered. The same applies for social tax benefits: when do they fall within the Regulation? These clarifications could be made in documents interpreting the Regulation or by an amendment to Regulation 883/2004.

Also the terms relevant to tax and social security coordination could be better adjusted, e.g. the terms residence and employer.

Further, the application of the schemes shows that there are many different approaches and philosophies between the Member States. As a result, mobile citizens may face serious problems in the fields of social security and taxation which may hamper their freedom of movement.

The differences between social security and tax systems make it difficult to harmonise the tax and social security coordination rules. However, it should be possible to harmonise some categories of the rules, where the problems are most urgent.

[18] The FreSsco Report mentions 24 months for Austria. See also article 4, mentioned above, for conflict rules.

One example is posting: at present there is even a growing divergence concerning the duration of the posting period for social security and tax; harmonisation of the period would be desirable. However, it is difficult to decide into which direction: should social security rules follow the tax rules or should tax rules follow the social security rules?

We could approach this issue from a principal point of view. Social security coordination rules are necessary to promote freedom of movement. It is consensus, though hard to prove, that a period of six months of posting is too short to allow free movement, as many projects take longer. In Regulation 884/2004 for this reason the posting period was extended to 24 months. Maybe there is room for a compromise: both twelve months.

Another issue where the lack of coordination is felt is that of frontier workers. The rules for determining the legislation applicable have to be better coordinated, for which purpose the *lex loci laboris* principle seems to be the most appropriate for promoting free movement, as this approach avoids distortion of competition.[19] Thus, the convergence must be in the direction of that solution that fits best with free movement of workers. This still leaves some room for different outcomes and even for compromises, but this principle shows a certain direction.

One could also think of a solution within the tax instruments.[20] For this purpose it is necessary to find or create a legal basis in the TFEU. Since article 45 TFEU requires promoting free movement, it is not farfetched to connect the issue to this article. It could mean that when the Treaty will be revised a specific provision is made to coordinate tax on income from employment for cross border situations.

At present Article 45 TFEU plays already a role on case where the discoordination of tax and social security leads to negative effects for mobile persons. The Court of Justice has ruled several times that rules hindering free movement are not consistent with the Treaty, see for instance the *Hendrix*- judgment.[21] However, far from all problems can be solved by such a way of interpretation of the Treaty. For this purpose it is useful to introduce a legal basis for making a regulation to address issues that have been problematic so far.

At the end of the day we will need an instrument that both coordination of social security and tax on income from work.

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[19] See for a more detailed discussion, F. Pennings, *Co-ordination of social security on the basis of the State-of-employment principle: Time for an alternative?*, Common Market Law Review 2005, 42 (1), p. 67–89.

[20] See for further discussion also the FreSsco Report.

[21] Case C-287/05, *Hendrix*, [2007] ECR I-6909.

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